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CHARLES ELMORE CROPLEY

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 442

PAUL O. BUCKLEY,

Petitioner,

vs.

ROSS W. JUDSON.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND SUPPORTING BRIEF.

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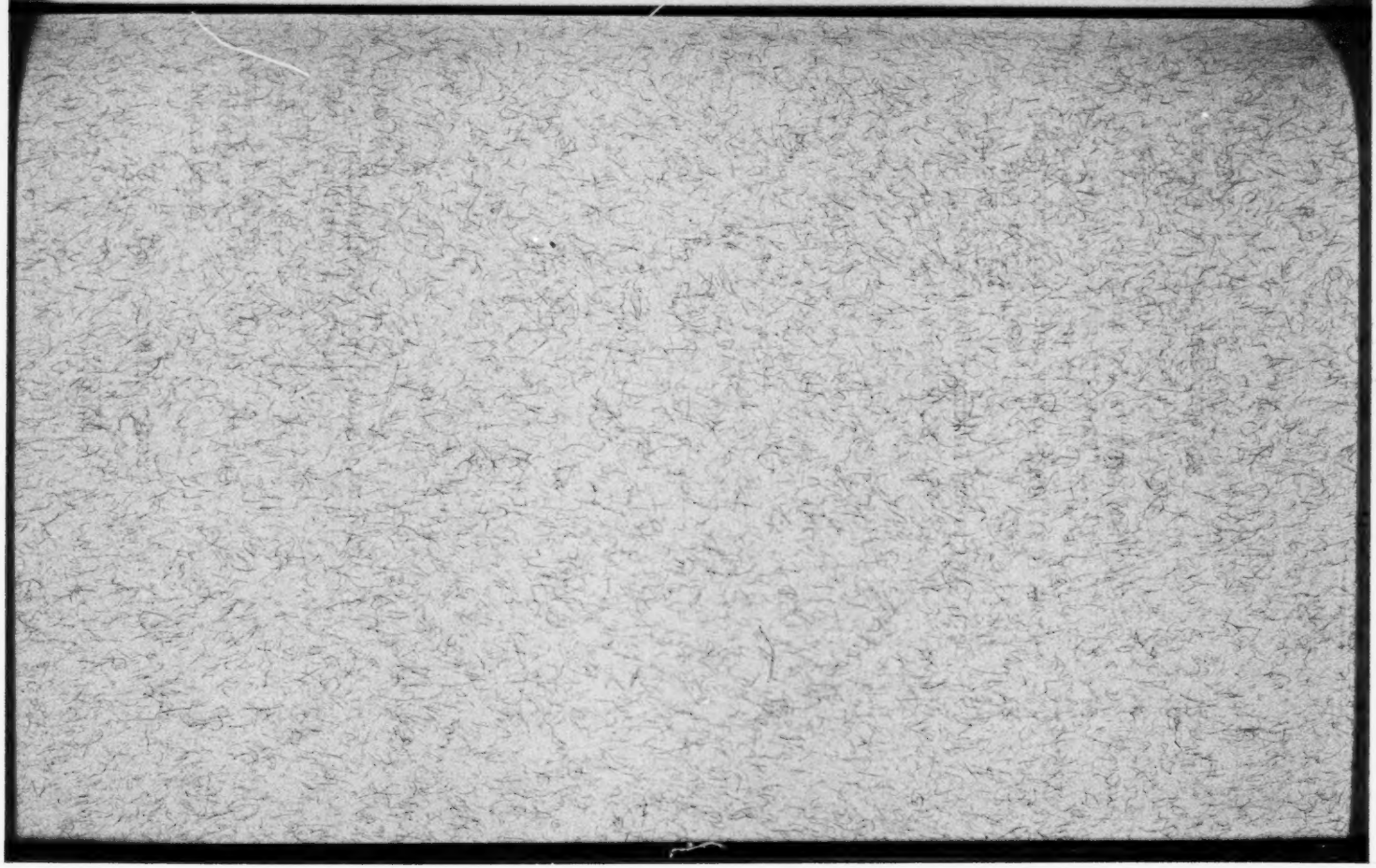

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Paul O. Buckley prays that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered September 8, 1942.

Opinions Below.

The report of the Special Master (R. 2439), the findings of fact and conclusions of law of the Special Master (R. 2461), the findings of fact and conclusions of law of the District Court (R. 2541) and the judgment of the Court (R. 2568) are not reported. The opinion of the Circuit Court of Appeals (R. 2588) is not yet reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on September 8, 1942. The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

1. Whether a secret agreement or arrangement found by the District Court to have been entered into by petitioner and respondent in connection with a public offering of stock for the purpose of deceiving the Securities and Exchange Commission and the public and which agreement or arrangement if carried out would render the representations made in the Registration Statement and Prospectus filed with the Securities and Exchange Commission false, is enforceable in the Courts of the United States.

2. Whether a principal who at the suggestion of an agent enters into a secret agreement or arrangement which is an essential part of a scheme to deceive the Securities and Exchange Commission and the public can enforce such an agreement if the false representations made by the principal and contained in the Registration Statement filed with the Securities and Exchange Commission were not shown to have in fact misled investors to their damage.

Statute Involved.

Statute involved is the Securities Act of 1933 (48 Stat. 44, 15 U. S. C. Sec. 77a *et seq.*).

Statement.

This suit was brought by respondent in equity among other things for specific performance of an alleged agreement made by petitioner to sell 18,000 shares of stock of the Bath Iron Works Corporation (hereafter called Bath

Corporation) to respondent at $6.00 per share (R. 24), to compel petitioner to pay respondent one-half of the profits derived from the sale of Bath stock to the public (R. 27) and to compel petitioner to account for certain transactions between them. The case was tried before Honorable Frederick E. Crane as Special Master, who made his report (R. 2439) to the United States District Court for the Southern District of New York, in which he held that the alleged agreement was void and unenforceable. Thereafter judgment was entered on February 19, 1942 (R. 2568) in favor of respondent for $191,622.95 (including interest), dismissing all other claims made by respondent against petitioner, including the claim for specific performance of the alleged agreement relating to the 18,000 shares of Bath stock and respondent's claim for a proportion of petitioner's syndicate profits, and dismissing petitioner's counterclaims.

This petition relates solely to that part of the opinion and decree of the Circuit Court which reverses the judgment of the District Court in dismissing respondent's claim for specific performance of the aforesaid agreement.

In order to have a clear understanding of the alleged agreement relating to the 18,000 shares of Bath stock, it is necessary to set forth here the events leading up to the agreement.

The Parties.

The petitioner was an attorney who gave up the practice of law in 1929 to engage in the securities business (R. 2461). In early 1930 respondent who was worth between four and five million dollars, intended to go into the stock market as an investor and speculator. Respondent met petitioner in May 1930 and there developed a close friendship and business relationship (R. 2462). Numerous brokerage accounts belonging to respondent were opened from time to time under the management of petitioner (R. 2463) respond-

ent retaining full control of said accounts in which both petitioner and respondent gave orders (R. 2537).

Acquisition and Marketing of Bath Stock.

In 1930 claims for income tax deficiencies were asserted by the Government against respondent which with interest and penalties for alleged fraud ultimately amounted to approximately $900,000 (R. 2464). Prior to 1935 the Government placed a lien on respondent's assets to secure the payment of such sum as might be due and nearly all of respondent's securities were held by the Collector of Internal Revenue at Detroit under this lien (R. 2465, 2590).

In Janunary 1935 respondent proposed to purchase notes and 2750 shares of common stock and 1000 shares of preferred stock of Bath Iron Works Corporation which stock represented control of the Company and was held by the Receiver of the Harriman National Bank as collateral security to an indebtedness of $300,000 (R. 2465). As a result of negotiations by petitioner (R. 2446, 2466), the notes and collateral were purchased for $135,000, in September 1935 with monies borrowed upon respondent's securities which the Collector released for that purpose, receiving the notes and Bath stock collateral thereto in substitution therefor (R. 2466, 2590). In January 1936, respondent purchased the 2750 shares of common stock and 1000 shares of preferred stock of the Bath Corporation at the foreclosure of the pledge, which stock continued to be held by the Collector under Government lien (R. 2466-7).

In March 1936 respondent bought out the interest of one Harbeck in the deal, and about the same time gave petitioner 25% interest in the Bath deal and stock in return for services and for which stock petitioner was to pay (R. 2467). Petitioner was to make the arrangements for selling the stock and carry on the negotiations with the

bankers (R. 2467). The arrangement according to the respondent between them with respect to the purchase of the stock was that they would participate in the cost and expenses as well as sales of the same upon a basis of 25% to petitioner and 75% to respondent (R. 2491).

In June 1936 the Bath stock which was in the possession of the Collector was transferred from the name of the Receiver of the Harriman National Bank, and new certificates were issued in lieu thereof, 25% in the name of petitioner and 75% in the name of respondent. Petitioner and respondent endorsed their respective certificates in blank and returned them to the Collector to be held under the Government lien (R. 2467-8).

Petitioner then enlisted the aid of Allen Melhado to carry on the negotiations and formulate a plan for marketing the stock. Through the negotiations of petitioner and Melhado, a recapitalization of the Bath Corporation and sale of the stock was proposed (R. 2468). The company was recapitalized on August 13, 1936 (R. 2469) as a result of which respondent became entitled to receive and did receive 133,837½ shares of new stock in exchange for the old stock then registered in respondent's name and petitioner became entitled to receive and did receive 44,612½ shares of new stock for the old stock then registered in petitioner's name (R. 2447, 2470) all of which remained subject to the Government lien.

Pursuant to the market arrangements, Hemphill, Noyes & Co. were to underwrite the purchase of 50,000 shares of new stock to be issued by the company and to market an additional 144,000 shares derived from the stockholders (R. 2469). Petitioner had obtained options from respondent and a group headed by Newell, the president of the company, covering a total of 144,000 shares whereby he was given the option to purchase their stock at $6.00 a shares (R. 2591). He then assigned these options to Hemphill, Noyes & Co. to carry out the marketing. The latter was to

pay $10.00 a share for the 50,000 shares and $6.00 a share for the 144,000 shares covered by the option. The 144,000 shares were to consist of 72,000 shares optioned to petitioner by the respondent and 72,000 shares optioned to petitioner by the minority stockholders headed by Newell and who were termed the "management group". The price to the public was $12.00 a share (R. 2468). Of the 144,000 shares, 25,000 were to be sold for the account of Hemphill, Noyes & Co. The six dollar underwriting profit on the remaining 119,000 shares was to be divided as follows: $1.00 per share to the bankers, commissions of 42¢ a share to Allen Melhado, and the balance divided between Hemphill, Noyes & Co. and Petitioner (R. 2468, 2591). These arrangements were carried out and fully disclosed in the registration statement filed with the Securities and Exchange Commission, pursuant to the Securities Act of 1933 (R. 2469).

The 72,000 shares to be sold by respondent were released by the Collector for that purpose, the proceeds to be used to satisfy his lien (R. 2004) and said shares, together with the remaining 72,000 shares optioned to petitioner, were deposited, pursuant to the Option Agreement (R. 2324), in escrow for delivery to the underwriters upon payment therefor (R. 2190-91). The remaining 61,837½ shares owned by respondent and the 44,612½ shares owned by petitioner were deposited, with the consent of the Collector and subject to his lien, with the principal underwriter, to be held in safekeeping for a period of one year, pursuant to the terms of a Safekeeping Agreement (R. 2332-3).

The Contract in Question.

Before the registration statement was filed, however, petitioner according to the findings told respondent that because he, petitioner, held options on 144,000 shares he could not sell any of his own stock "because under the laws of the S. E. C. you cannot do that" and that respondent

was to sell 18,000 shares of his stock for petitioner which petitioner would reimburse and return to respondent later on at $6 per share. Petitioner further told respondent that in addition to the $6.00 per share respondent would receive $2.00 or $3.00 per share from the syndicate (R. 2453-4, 2469). This arrangement was denied by petitioner but was found by the Court to have been entered into between petitioner and respondent (R. 2457). In any event it was not disclosed in the registration statement. On the contrary, the statement falsely declared that the petitioner who was deemed to be an underwriter, owned 44,612½ shares, none of which were to be sold, that the stockholders, including petitioner, had agreed not to sell any of their stock except that offered in the option agreement during the life of the option agreement, and that respondent was selling 72,000 shares of his own stock for which he was to receive $6.00 a share (R. 2592).

Findings[1] *of the District Court.*

The District Court found that the registration statement and the agreements signed by respondent in connection with the preparation thereof were false (R. 2455, 2473, 2479); that the arrangement between petitioner and respondent respecting 18,000 shares and the syndicate profits was entered into between them for the purpose of (1) concealing petitioner's interest in the stock to be offered for sale, (2) inducing more people to buy the securities if the arrangements were not revealed, and (3) make possible the deal for double profits which, it was feared might not be permitted if known; that the concealment of the true facts and the false representations in the registration statement filed with their knowledge and consent were in violation of the Act (R. 2541-2).

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[1] These findings include the findings of the Special Master confirmed by the District Court (R. 2544).

The District Court found further that the secret agreement or arrangement as to the 18,000 shares, the splitting of the underwriting profits and the false representations were all part of a scheme to deceive the Securities and Exchange Commission and the public; that it would be encouraging deceit and contrary to public policy for the Court to lend its aid in carrying out a conspiracy of this character; that the arrangement or agreement was an essential part of a scheme that was illegal and entered into for improper purposes (R. 2542). The District Court also found that respondent and petitioner were "experienced manipulators"; that the contracts between them were made for the purpose of concealing the fact that petitioner had an interest in the sale of the stock and as an aid to the falsification of the registration statement and were entered into by them to circumvent the rules and regulations of the Securities and Exchange Commission; that the method and reasons were discussed by them; that what was done by respondent was done deliberately and purposely, and that if there be any conflict between the application of the rule for the protection of a fiduciary relationship and the rule holding illegal contracts unenforceable the latter rule should prevail under the circumstances here presented (R. 2543-44).

Opinion of the Circuit Court.

The Circuit Court in an opinion by Judge Augustus N. Hand overruled the Special Master and the District Court and held that respondent was entitled to a decree requiring petitioner to transfer to him the 18,000 shares of the Bath stock and concluded that respondent's claim for the syndicate's profits had been satisfied and must be dismissed. In its opinion the Circuit Court held that the errors in the registration statement could not mislead prospective purchasers as to the value of the stock or really prejudice

them in any way (R. 2593); that while the accuracy and propriety of the statements petitioner and respondent made may not be defended it seemed necessary to consider the position in which respondent stood before depriving him of his contract right; that respondent was in a position of a person having nothing to gain by any errors in the registration statement and that so far as he had any share in them he had it because of the guidance of petitioner who was his agent and confidential adviser; that a sound public policy would not be promoted by depriving a principal of the right to hold his agent accountable in situations like the present (R. 2594); and that no misstatements were made to the Commission in respect to matters which might mislead investors to their damage (R. 2595).

Reasons for Granting the Writ.

1. There is involved here an important question of Federal law which has not been but should be settled by this Court.

2. There is involved here an important question in the administration of the Securities Act of 1933 which it is in the public interest to have decided.

3. The Circuit Court has decided an important question of Federal law in a way probably in conflict with applicable decisions of this Court and with the weight of authority.

4. Because it is a matter of public importance to know whether or not the Courts of the United States will enforce agreements or arrangements which are essential parts of a scheme to deceive Governmental agencies and the public.

5. The Courts below in this case have come to opposite conclusions and differ as to the legal effect of the agreement or arrangement entered into between the petitioner and respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The case involves an important question in the administration of the Securities Act of 1933 which it is in the public interest to have decided. No case heretofore has arisen in which a Federal Court has been called upon to determine whether it shall grant or deny specific performance of an agreement touching the marketing of securities where such agreement was, in violation of the provisions of the Securities Act of 1933, falsely represented in the registration statement filed with the Securities and Exchange Commission. The Circuit Court reversed the decision of the District Court in which it had been held that the agreement should not be enforced because it was an essential part of an illegal scheme and the parties should be left where they found themselves.

The Circuit Court's opinion will have the effect of frustrating the purposes of the act in three important particulars:

(1) If persons identified with the marketing of securities are assured that the Courts will hold valid and enforceable contracts the purpose of which is to deceive the investing public, such agreements will multiply. The decision declares that the Courts will regard as enforceable, and to that extent valid, an agreement entered into for the purpose of concealing respective interests of the offerors of stock and for the purpose of inducing investors to buy more stock than they would if the agreement were revealed in the manner contemplated and required by the Securities Act. The decision thus gives validity to that which the Securities Act is designed to prevent. To that extent the decision encourages rather than discourages falsity in registration statements, thereby thwarting the

primary purpose of the Securities Act—truthful disclosure as to each new security issue, to the end that no essentially important element attending an issue shall be concealed from prospective investors or misrepresented to them. The decision is, therefore, contrary to the generally accepted principle enunciated in such cases as *Sage* v. *Hampe,* 235 U. S. 99, 105; *McMullen* v. *Hoffman,* 174 U. S. 639, 669-70; *Primeau* v. *Granfield,* 193 Fed. 911, cert. den. 225 U. S. 708; *Barnsdall* v. *Owen,* 200 Fed. 219.

(2) The decision is erroneous in its determination that the false representations in the registration statement were immaterial. The Circuit Court in its opinion minimizes the importance of the falsehoods here involved and in effect holds them to be harmless or not material. The opinion does not use the word "material" but the Court says:

> "We do not see that any misstatements were made to the Commission in respect to matters which might mislead investors to their damage"; "nor can we see that the errors in the statement could mislead prospective purchasers"; that "the public offense committed by Judson * * * was one of little practical significance"; and that the "violation of the Securities Act * * * never caused investors in the stock any harm * * *."

By such language the Court thereby fixes standards of harmfulness and of materiality which will render the Commission impotent in many cases in its attempts to enforce the Act. The "materiality" of a representation in a registration statement is an issue of great importance in prosecutions under Section 24 of the Securities Act (15 U. S. C., Sec. 77x) providing criminal penalties for any person who "makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading." Material misstatements or omissions in registration statements or

prospectuses may give rise to civil liabilities to purchasers (§§ 11 and 12(2), 15 U. S. C., §§ 77k and 77l(2)), stop order proceedings by the Commission (§ 8(d), 15 U. S. C., § 77h-(d)), and suits by the Commission for injunctive relief (§ 20(b), 15 U. S. C., § 77t(b)). A ruling, therefore, that the representations in this case which were found by the Master and the District Judge to have been deliberately and purposefully made (R. 2544) and for the purpose of deceiving investors (R. 2542), are immaterial—and that is the effect of the decision—has wide implications which make it in the public interest that the decision be reviewed by this Court.

Whether the agreement is to be enforced should be determined not on the narrow basis of whether investors were in fact harmed by the failure to disclose, but rather whether there is a public policy against such enforcement. The public policy against enforcement may be found either (1) by looking to the purpose of the conduct and its possible effect upon investors or (2) by looking to the public policy against such enforcement which is to be found in legislation of recent years.

(3) The Court found specifically that the secret agreement as to the 18,000 shares, the splitting of underwriting profits, and the false representations were all part of a scheme to deceive the Securities and Exchange Commission and the public (R. 2542). Other findings strengthening this conclusion are set forth herein (*infra*, pp. 7, 8). These findings are not controverted by the Circuit Court, however submerged they may be in its discussion. By any interpretation of Civil Rule 52, such findings cannot be discounted, particularly where, as here, the evidence was conflicting and one of the elements involved in the District Court's determination was the relative credibility of the two principal witnesses. (See *Malloy* v. *New York Life Insurance Co.*, 103 F. (2d) 439.)

In addition to the purpose to deceive, there was here also the likelihood that the public would be deceived. The test here should be objective rather than subjective. Would the average investor reasonably be led to a different conclusion regarding his decision to purchase or not to purchase? The information that petitioner, an underwriter and large stockholder was or was not selling his stock is information which should be disclosed to a prospective investor, and would undoubtedly influence an investor in determining whether or not to buy the stock offered to the public. If two "experienced manipulators" such as the Court found respondent and petitioner to be, thought it important that their arrangement be concealed in order to deceive the Securities and Exchange Commission and the public, who is to say in applying an objective test that their fears as to the risk involved in disclosure were ill-founded? In addition, it is extremely unlikely that the Management group, who under the marketing arrangements were supplying 72,000 shares of stock, would have gone along with the marketing program had they known of the secret profits which respondent was to receive.

This Court should determine whether under these circumstances the decision of the District Court was erroneous when it stated:

> "This secret agreement or arrangement as to the 18,000 shares of Bath Iron Works stock, the splitting of underwriting profits, and the false representations are all part of the scheme to deceive the Securities Exchange Commission and the public. I agree with the Special Master that the part of it which the plaintiff now seeks to enforce is illegal and unenforceable. In my opinion it would be encouraging deceit and contrary to public policy for this court to lend its aid in carrying out a conspiracy of this character."

The Circuit Court while recognizing that petitioner and respondent were co-adventurers, nevertheless stressed the

principal and agent relationship existing between the parties (R. 2594). On this the District Court said (R. 2543):

> "The contention of plaintiff that the parties are not in *pari delicto,* assuming that plaintiff was less guilty than defendant is inapplicable, for the Master has found that both Judson and Buckley 'were experienced manipulators' and that the contracts between Judson and Buckley were made for the purpose of concealing the fact that Buckley had an interest in the sale of the stock, and as an aid to the falsification of the Registration Statement, and were entered into by Judson and Buckley to circumvent the Rules and Regulations of the Securities and Exchange Commission. The method and the reasons were discussed by Buckley and Judson. What was done by Judson was done deliberately and purposefully. If there be any conflict between the application of the rule for the protection of a fiduciary relationship and the rule holding illegal contracts unenforceable, the latter rule should prevail under the circumstances here presented."

For the Circuit Court to emphasize the fiduciary relationship as a reason for granting specific performance in this case is to create an anomalous situation in the law in which the closer the relationship of conspirators, the more disposed are the courts to enforce arrangements between them.

The only reported case dealing with the enforcement of contracts involving a violation of the Securities Act of 1933 is that of *A. C. Frost & Co.* v. *Coeur d'Alene Mines Corporation,* 312 U. S. 38. That case involved a suit by an underwriter against the issuer for breach of contract. The plaintiff, through its agent, had been given an option by the defendant issuer on 1,300,000 shares of its treasury stock at 10 cents a share. The option agreement was later modified to authorize the issuer to sell the shares directly and credit plaintiff with the proceeds over and above 10 cents a share. Plaintiff sued for (1) damages for the refusal to deliver all the stock under the option agreement and (2)

the excess above 10 cents a share received by the issuer on certain sales to other persons. The issuer's defense was that the shares had never been registered under the Securities Act of 1933, in violation of Section 5 of that Act (15 U. S. C. § 77e). This Court gave judgment on both causes of action holding that the essential purpose of the act would, on the facts in that case, actually be hindered by non-enforcement.

In the present case there is, however, no need to balance against the benefit which would accrue to investors from the point of view of discouraging future illegal agreements any harm which they might suffer from refusing to enforce the illegal agreement before the Court, because they would suffer no harm as a result of non-enforcement. Since there is no investor interest, immediate or otherwise, to be served by enforcing the agreement, the conclusion seems to be compelled that the ultimate protection of investors and the public generally would be better served by refusing to buttress the unlawful conspiracy with the legal process of the courts.

The case at bar is not a mere claim of illegality for non-compliance with the law, or with the rules and regulations of a governmental body, but one in which the Court found active fraud and purposeful deceit in the making of false representations and in concealing facts from a governmental body, in which deceit the alleged agreement played an essential role and by which respondent hopes to profit.

No such facts exist in the *Frost* case. There was neither false representations nor concealment. There were no dealings with the governmental body and no Registration Statement. The *Frost* case was an action at law, and not in equity. Frost & Co. sought damages for breach of contract for the sale of stock and defendant set up illegality because the stock had not been registered under the Securities Act. This Court found there was no evidence of criminality (p. 42); that the contract was fair on its face (p. 42); and the

public was better protected by enforcement than non-enforcement (p. 43).

There is no comparison between the culpability of one who fails to file a Registration Statement because he believes, although perhaps mistakenly, that the offering is not a public offering, and that registration is not necessary, and those who deliberately conceal facts and sign and file false statements for the purpose of deceiving the public and the Securities and Exchange Commission, as the Master and the Court found was done by the Registration Statement and the secret oral agreement in this case.

In addition to the above considerations Congress has established a legislative policy against enforcement of such contracts. In the Circuit Court of Appeals, counsel for respondent in arguing that the arrangement in the present case was not contrary to public policy and therefore not void, stressed the fact that to deny relief in this case would be to add to the sanctions in the form of criminal penalties and civil liabilities which were provided by Congress when it enacted the Securities Act of 1933. But the Act itself contemplates additional sanctions to those prescribed in the statute.

The Securities Act of 1933 specifically provides in Sec. 77p, Title 15, that the "rights and remedies provided by this sub-chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity". In other words, by the very terms of the Act it is contemplated that other sanctions shall still be available.

In determining whether there is a public policy which renders such contracts unenforceable it is important to look into the Federal legislation of recent years dealing with securities.

In the Securities and Exchange Act of 1934, 15 U. S. C. Sec. 78cc it is provided that:

> "(b) Every contract made in violation of any provision of this chapter or of any rule or regulation there-

> under, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, * * *"

Virtually identical provisions are found in the Public Utility Holding Company Act of 1935, 15 U. S. C. Sec. 79z; the Investment Companies Act of 1940, 15 U. S. C. Sec. 80a-46; and the Investment Advisers' Act of 1940, 15 U. S. C. Sec. 80b-15.

It should be remembered that the Securities Act of 1933 was the first in this series of acts having to do with investments. Each of the subsequent Acts contains the provision indicating quite clearly a Congressional policy that the Courts shall not enforce agreements made in violation of the Acts. If the early Acts had contained the provision and the subsequent acts had omitted it it might then well be argued that the Congress did not intend that such contracts should be regarded as void and unenforceable in suits for specific performance. Here, however, we have expressions from the Congress since the enactment of the Securities Act of 1933 from which can be spelled a consistent and uniform policy that such contracts shall not be enforceable. The same basic principle underlying the Securities Act likewise underlies the Acts which followed it.

The public policy underlying each is the same. One purpose of the Securities Act of 1933 as outlined in the Report of the Committee on Banking and Currency was to prevent exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor.

One purpose sought in the passage of the Securities Exchange Act of 1934 was to make available to the average investor honest and reliable information sufficiently complete to acquaint him with the current business conditions of the company, the securities of which he may desire to buy or sell. The 1934 Act supplements the 1933 Act and in turn the enactments of 1935-1940 supplement the first two, and behind each there is a common purpose. The pattern of each is likewise much the same. For example, in each of the Acts there is provision for registration statements and reports to the Commission. The registration requirements provided for in the Securities Act, 15 U. S. C. Secs. 77f, 77g are of the same pattern as the registration requirements in the Securities and Exchange Act, 15 U. S. C. Secs. 78*l*, 78m, 78o, and 78o-3; the Public Utility Holding Company Act, 15 U. S. C. Sec. 79e; the Investment Companies Act, 15 U. S. C. Secs. 80a-8, 80a-24; and the Investment Advisers' Act, 15 U. S. C. Secs. 80b-3, 4. To hold that there is a public policy against enforcement of contracts the performance of which involves a violation of the registration provisions of the Acts of 1934, 1935, and 1940, but that there is no such policy as far as the violations of almost identical registration provisions of the Securities Act of 1933 is unrealistic. The public policy behind non-enforcement which is specifically recognized in recent legislation should be recognized by the Court.

The question is not whether the Securities Act specifically declares such contracts unenforceable. The question is whether there can be found in the legislation of recent years a public policy which holds such contracts void. Upon examination we find just that. Whether a contract shall be enforced requires consideration of the broad purpose of the Securities Act and, of the broad purposes of relevant statutes.

In a Governmental structure in which administrative agencies require, in the public interest, numerous disclosures of personal and business dealings, it is important to have it declared whether the Courts of the United States will enforce any arrangement which is an essential part of a scheme to defeat the Governmental requirements of disclosure. The importance of clarity on the subject of enforceability of such arrangements applies not only in the case of transactions which come within the purview of the regulations of the Securities and Exchange Commission, but to all types of secret, undisclosed transactions which under the laws of the land are made the subject of scrutiny by the other numerous agencies of the Government. By the decision in the present case, doubt is thrown as to the present applicability of the heretofore well-recognized principle that a contract, the object of which is the deception of the public and of public officials in the performance of their duties, is contrary to public policy, void and unenforceable. The Circuit Court does not purport to repudiate this doctrine in general terms, but in denying its applicability to the facts in the present case it does for all intents and purposes reject the doctrine in a situation where it has been generally conceded that it should apply.

Conclusion.

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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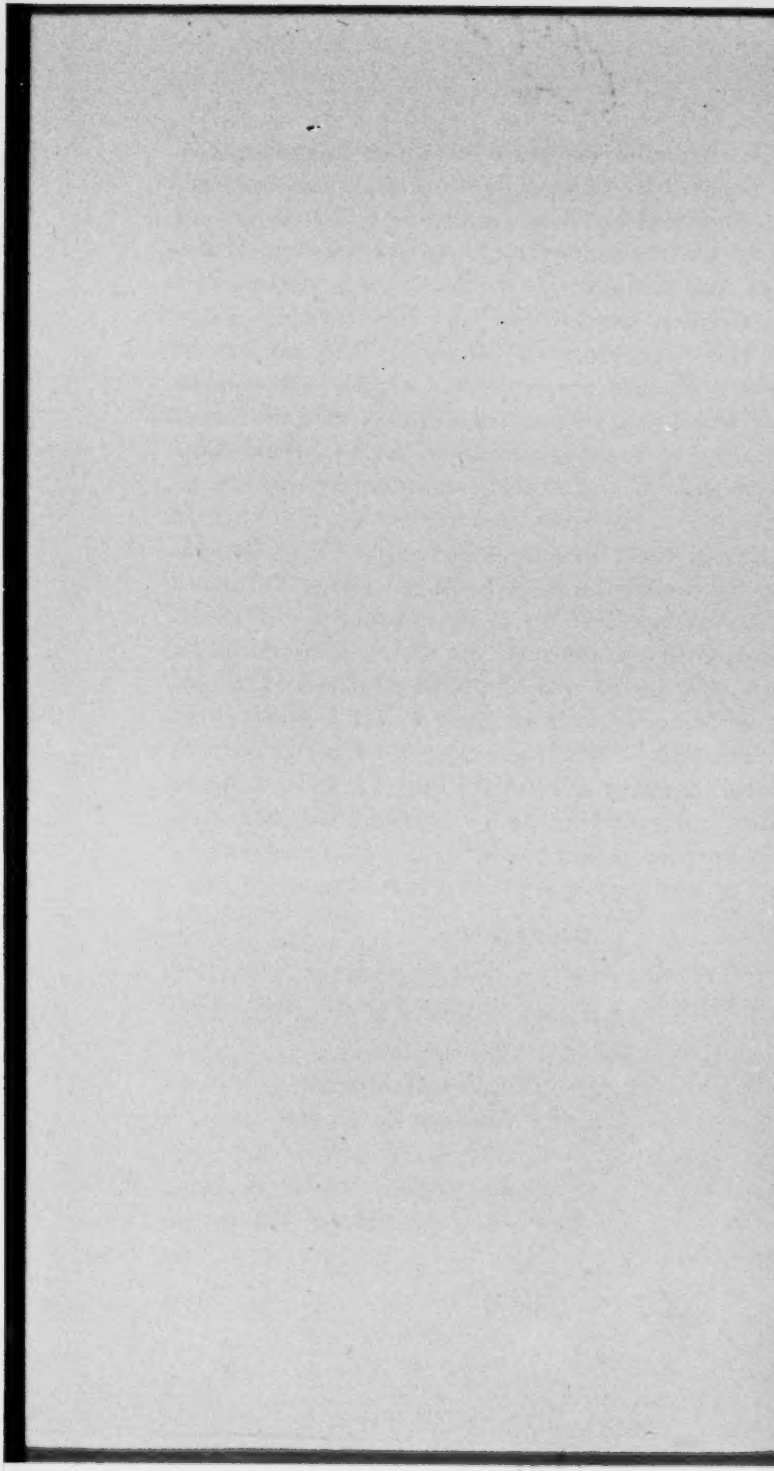
October 3, 1942.



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OCTOBER TERM, 1942

No. 442

PAUL O. BUCKLEY,
Petitioner,

vs.

ROSS W. JUDSON,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

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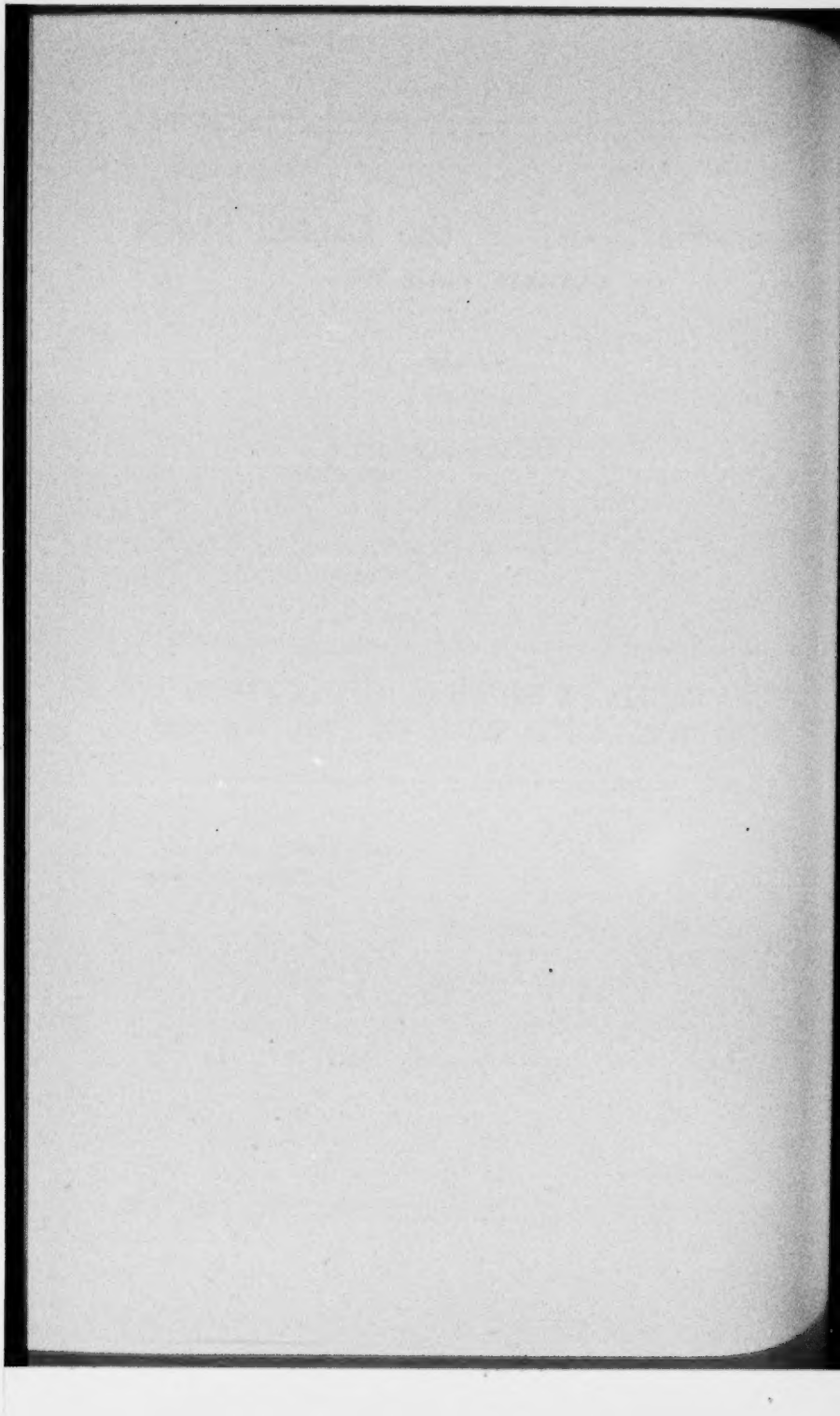

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Supreme Court of the United States

OCTOBER TERM, 1942

No. 442

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ROSS W. JUDSON,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

Opinions of Courts Below

The opinion of the District Court is not reported. The opinion of the Circuit Court of Appeals (Judges Augustus N. Hand, Clark and Frank) is reported in 130 F. (2d) 174.

Jurisdiction

The jurisdiction of the lower Federal Courts was based upon diversity of citizenship. Petitioner is attempting to invoke the jurisdiction of this Court under Sec. 240(a) of the Judicial Code, as amended.

Questions Presented

1. Whether a court of equity will refuse to enforce the obligations of a trusted confidential adviser and agent under his agreement to reimburse his principal by delivering to him shares of stock to replace shares sold by the principal

for his account,—the shares in question having formed part of a public offering of stock by others,—upon the ground that the existence of such agreement was not stated in a registration statement, where the agreement between the parties was in itself valid in every respect, and where the principal was not a party to the registration statement and took no part in its preparation and the non-disclosure was not in the contemplation of the principal, and where the confidential adviser and agent actively participated in the negotiations for the marketing of the stock and the preparation of the registration statement, and where the principal relied implicitly upon his advice with respect to the matter in controversy.

2. Whether the trusted confidential adviser and agent can so avoid his obligations, irrespective of the materiality of the omission of mention of such agreements in the registration statement,

(a) Where such agent knowingly misrepresented that "under the laws of the S. E. C." he could not sell any stock registered in his name, and the principal relied upon such statement and the agent's advice that it was necessary to cast the transaction in the form adopted in order to comply with the law, and

(b) Where such agent has received the benefits of the principal's performance, and

(c) Where the principal was not a party to the registration statement, took no part in its preparation and had no knowledge as to whether reference in the registration statement to the existence of the agreement between him and such agent was necessary, and had no knowledge until two months later that such agreement was not mentioned in the registration statement and could realize no advantage from any such omission, and

(d) Where the parties, because of their relationship and conduct, were not in *pari delicto,* and

(e) Where any wrong done is a thing of the past, is collateral to the cause of action asserted and the relation of any illegality to the relief sought is indirect and remote.

3. Whether the trusted confidential adviser and agent can so avoid his obligations, where the agent's title to the stock was never complete, and where the stock which is the subject matter of the suit is in the custody of the court under what in effect is an order of interpleader, so that a refusal by the court to act in favor of the principal would amount to affirmative action in favor of the agent.

The questions advanced by petitioner are not in fact presented. They disregard the opinion of the Circuit Court of Appeals and are framed upon findings of the District Court as to a "secret agreement or arrangement" which are not supported by the record and which the Circuit Court of Appeals in effect reversed. Furthermore, the decision of the Circuit Court of Appeals did not depend upon whether there had been compliance with the Securities Act of 1933 (48 Stat. 44, 15 U. S. C. 77(a), et seq.).

Statement of the Case

This suit was instituted by respondent to secure an accounting from petitioner with reference to numerous transactions between them during the period from 1930 through 1937 and to obtain specific performance of petitioner's agreement with reference to 18,000 shares of stock of Bath Iron Works Corporation (hereinafter called Bath Corporation) and to enforce a lien against petitioner's interest in Bath Corporation stock (R. 8 to 30).*

Respondent was awarded a judgment, upon the accounting which was granted by both the Special Master and the

* References are to pages in the record, unless otherwise indicated. References to exhibits are to complainant's exhibits, unless the letters "D's" are used.

District Court, in the sum of $191,622.95 and respondent's lien was recognized (R. 2568-73). Respondent appealed to the Circuit Court of Appeals from the refusal of the District Court to enforce the agreement with respect to 18,000 shares of Bath Corporation stock, the existence of which had been found by the Master and by the District Court (R. 2469-70, 2491, 2489, 2473-4, 2541). The Circuit Court of Appeals granted enforcement, stating in part:

> "* * * sound public policy will not be promoted by depriving a principal of the right to hold his agent accountable in situations like the present.
>
> Numerous authorities support the view that a suit for recovery is not barred in cases where: (a) the parties, because of their relationship and conduct are not in pari delicto, Ford *v.* Harrington, 16 N. Y. 285; Tracy *v.* Talmadge, 14 N. Y. 162, 67 Am. Dec. 132; Norton *v.* Blinn, 39 Ohio St. 145, 149; Place v. Hayward, 117 N. Y. 487, 23 N. E. 25; 6 Williston, Contracts, Rev. Ed., §1789; (b) where any wrong done is a thing of the past, and is collateral to the cause of action asserted and where the relation of the illegality to the relief sought is indirect and remote, Loughran *v.* Loughran, 292 U. S. 216, 228, 54 S. Ct. 684, 78 L. Ed. 1219; Planters' Bank *v.* Union Bank, 16 Wall. 483, 499, 21 L. Ed. 473; Brooks *v.* Martin, 2 Wall. 70, 17 L. Ed. 732; Hanover Nat. Bank *v.* First Nat. Bank, 8 Cir. 109 F. 421; State *v.* Capital City Bank, 32 N. M. 369, 257 P. 993; (c) where the res sought to be recovered is held in escrow under what is in effect an order of interpleader so that a refusal to act in favor of the complainant will amount to affirmative action in favor of the other party. Buchhalter *v.* Rude, 10 Cir., 54 F. 2d 834, modified as to costs 286 U. S. 451, 52 S. Ct. 605, 76 L. Ed. 1221; Commonwealth Finance Corp. *v.* McHarg, 2 Cir., 282 F. 560; Langley *v.* Devlin, 95 Wash. 171, 163 P. 395, 4 A. L. R. 32.
>
> Each of these three conditions exists here. Moreover, we do not see that any misstatements were made to the Commission in respect to matters which might mislead investors to their damage.
>
> In view of the foregoing, it seems to us that Judson is entitled to a decree ordering the delivery to

him of 18,000 shares of Bath Iron Works stock now standing in the name of Buckley. * * * " (R. 2594-5) 130 F (2d) 174, 180.

The Relationship Between the Parties

Petitioner and respondent became acquainted in the spring of 1930 and petitioner represented himself as being experienced and skilled in matters relating to finances and securities (R. 2462). Petitioner was a lawyer who had given up the practice of law in 1929 "to engage in the securities business and the business of advising others with respect to investments and business ventures" (R. 2461). Respondent was a retired industrialist of considerable means, while petitioner had no capital (R. 2461-2; 1964-5; 885-6). A very close friendship and business relationship was rapidly developed between them and by the end of 1930 they were together practically every day and discussed all of respondent's personal and business affairs (R. 309, 317, 320, 972, 1004, 1098). During the latter part of 1930, petitioner rendered some services to respondent and was paid a fee in one matter (R. 2462) and refused compensation in the other, but suggested that he would be amply compensated and both parties would benefit if respondent would "permit Buckley to manage brokerage accounts for Judson under an arrangement whereby Buckley would receive 25% of the trading profits" (R. 2463). Respondent concurred in petitioner's suggestion, and in January, 1931, opened a brokerage account and entrusted the management thereof to petitioner (R. 2463). Subsequently a series of substantial brokerage accounts were opened with respondent's capital under the same arrangement, and petitioner retained authority to operate all of these accounts as long as they continued in existence—until the latter part of 1937 (R. 2463). The agreement under which the profits from these accounts was to be divided was never reduced to writing, and as a matter of fact, neither of these parties kept any written record of their many dealings together, but relied on their close friendship and relationship to avoid any misunderstandings (R. 2439).

The only written agreement which they ever made between themselves involved their relationship in the transactions in Bath Corporation stock, and this agreement was only reduced to writing at the insistence of accountants long after the original transaction (R. 2473-4, 217-8).

The transactions in respondent's brokerage accounts operated by petitioner were extensive. Some idea of the magnitude of the operations managed by petitioner can be gained from the fact that respondent's losses in the accounts from 1931 through 1937 amounted to more than $600,000 (R. 2463). Under the agreement between them, the petitioner risked no capital and did not have to bear any portion of the loss.

Petitioner had charge of all of respondent's financial affairs and respondent relied upon petitioner to obtain funds from respondent's assets under his control to meet respondent's obligations and he advised people with whom he was dealing that his affairs were in petitioner's hands (D's Ex. 89, R. 2412, 1974; D's Ex. 93, R. 2416, 1976). All of the witnesses who testified concerning the relationship between the parties told of their more or less constant association, (R. 1763, 1818) and one of petitioner's witnesses said that he "considered Buckley Judson's alter ego * * * Any time I talked to Buckley, I figured I was talking to Judson" (R. 1540).

Respondent reposed complete trust and confidence in Buckley and relied upon his advice and depended upon his judgment (R. 292). Respondent signed papers which petitioner presented to him without making any personal examination. He testified "I did not examine what they were. Mr. Buckley told me they were all right and in order, and I just signed them" (R. 211; see also 368, 1978).

The Bath Transaction

In September, 1935, respondent purchased from the receiver of the Harriman National Bank a past due promissory note (of a third person) secured by the pledge of a

majority of the outstanding stock of Bath Corporation. Upon acquisition, the promissory note and pledged stock were delivered to the Collector of Internal Revenue at Detroit to be held subject to the lien of a deficiency assessment against respondent. The pledge was foreclosed in January, 1936, respondent becoming the owner of the pledged stock, which continued to be held by the Collector subject to such lien (R. 2466).

Petitioner and one Harbeck had rendered services to respondent in this transaction, and in March, 1936, respondent paid $10,000 to Harbeck in full settlement for the services rendered by him and at about the same time, at petitioner's suggestion, respondent agreed to give to petitioner 25% of all of the profits from the Bath deal (R. 2467, 2512, 202). Shortly thereafter, at petitioner's suggestion, respondent agreed that instead of 25% of the profits, petitioner should have a 25% interest in the deal, for which petitioner was to pay 25% of all costs and expenses and was also to arrange for marketing the stock, and respondent was "to be under no expense for that" (R. 2467, 2512-3, 204). Petitioner has paid no part of the costs and expenses, the amount thereof being included in the judgment in the present case (R. 2474, 2553).

It was agreed at that time that all sales of the stock should be made 25% for the account of petitioner and 75% for the account of respondent (R. 204, 206). Subsequently, in April, 1937, this agreement was reduced to writing and expressed in a promissory note and memorandum attached thereto (Exs. 280 A and B, 224 A and B; R. 2196-7; 2162-3; 551; 405, 2519).

In June, 1936, the Collector presented the stock certificates for transfer and new certificates were issued, of which 25% were registered in the name of petitioner and 75% in the name of respondent. All the new certificates were immediately endorsed by the registered owners and returned to the Commissioner, who continued to hold them until the public offering of Bath Corporation stock was undertaken (R. 2467-8, 2513).

Petitioner and one Allen Melhado carried on negotiations for marketing Bath Corporation stock, and in the summer of 1936, an arrangement with respect to marketing the stock was made with a group of underwriters headed by Hemphill Noyes & Co. The arrangement called for a public offering of 194,000 shares of which 50,000 shares represented a new issue by Bath Corporation and 144,000 shares represented outstanding stock, one-half of which, or 72,000 shares, was to be made available under option from the stock owned by petitioner and respondent.

Respondent took no part in the negotiations which were carried on with the prospective underwriters (R. 1029-30; 2468, 813-4; 1274, 683, 1025, 1925). The petitioner kept respondent and other stockholders of Bath Corporation advised concerning the progress of the negotiations.

The agreement between petitioner and respondent contemplated that sales of Bath Corporation stock should be in a 75%-25% proportion.

After the tentative arrangement with the prospective underwriters petitioner told respondent that "I am the optionee and cannot sell any of my stock because under the laws of the S.E.C. you cannot do that" (R. 2469-70). This statement was not correct (R. 2514, 2592). Petitioner said that respondent would have to sell 18,000 shares of stock, that being 25% of the shares which were to be offered from the stock owned by petitioner and respondent together, for the account of petitioner, and that petitioner would "reimburse" to respondent the shares sold for petitioner's account (R. 210). Petitioner also told respondent and the other stockholders that he was to receive half of the underwriting profits, after certain deductions, and that this would be divided among the stockholders who sold their stock so that they would receive an additional $2 or $3 per share for the shares which were taken by the underwriters (R. 210-1; 1852, 2486-7).

A registration statement to be executed and filed by the Bath Corporation covering the public offering was prepared

by attorneys for the underwriters, and respondent took no part in its preparation, except to sign a written statement which correctly set forth his total holdings of Bath Corporation stock (D's. Ex. 97, R. 2423-5; 1979).

The registration statement correctly disclosed that respondent had given an option upon 72,000 shares of stock and that other stockholders had also given options upon 72,000 additional shares of stock. It disclosed that petitioner and respondent were associates in various business enterprises and it showed the exact amount which was to be paid by the underwriters for the stock which they purchased and the exact amount for which the stock was to be resold to the public (D's Exs. 27 and 28, R. 2334-61; 692). Petitioner claims that the registration statement was deficient because it failed to show that 25% of the stock optioned by respondent was for the account of petitioner and that petitioner had agreed to divide his part of the underwriting profits with the respondent. Respondent made no representation to the registrant, underwriters or experts who prepared the statement, concerning these matters, nor was he a party to nor did he sign the registration statement. Petitioner, on the other hand, confirmed in writing to the registrant and the underwriters the correctness of the statements in the registration statement concerning such matters (Ex. 250, R. 2169, 481).

The Collector of Internal Revenue, in accordance with instructions from petitioner and respondent, deposited certificates representing 72,000 shares of stock registered in the name of respondent for delivery upon exercise of the option to the underwriters, and deposited the balance of the certificates, registered in the names of petitioner and respondent, in escrow with the principal underwriter, and the receipts issued by the principal underwriter for this deposit were endorsed by petitioner and respondent, respectively, and returned to the Collector of Internal Revenue (Exs. 248 and 249, R. 2168, 481). Later, petitioner and respondent assigned a part of the shares held by the prin-

cipal underwriter to the Bank of Manhattan as security for a joint loan, and upon termination of the escrow agreement, the shares so assigned were delivered to the Bank of Manhattan, where they were held at the time of the commencement of this suit. Subsequently, the Bank of Manhattan, pursuant to stipulation and order, deposited these certificates with the Clerk of the District Court, in which the suit was pending (R. 97 to 102).

All of the optioned stock was taken down by the underwriters and sold.

Summary of Argument

1. There is no question of federal law involved in the decision of this case.

2. The decision in this case is based upon findings of fact having no connection with the Securities Act of 1933 as follows:

(a) The fiduciary nature of petitioner's relation to respondent;

(b) The lack of any participation by respondent in the alleged illegality;

(c) The alleged illegal scheme was conceived by petitioner, and respondent agreed to the plan suggested by petitioner upon petitioner's false representation that a different method of accomplishing the same result would be illegal;

(d) Respondent was not in *pari delicto* with petitioner who had charge of arranging the underwriting and upon whom petitioner relied;

(e) The contracts between petitioner and respondent were legal, valid and binding;

(f) There was no agreement that the contractual relationship should be used in an improper manner and petitioner had no knowledge of any intended improper use and no motive to concur therein;

(g) The alleged improper acts (the omission to mention provisions of the contractual relationship in the registration statement) were remote in point of time and only indirectly connected with the contracts themselves;

(h) The alleged illegality was a thing of the past which was collateral to the cause of action asserted upon the valid contracts;

(i) The subject matter of the suit was held in escrow under what is in effect an order of interpleader so that a refusal to enforce the agreement in favor of respondent would amount to granting affirmative relief in favor of the other party who was alone responsible for the asserted illegality.

3. The decision of the Circuit Court of Appeals on the law applicable to the foregoing facts is entirely in accordance with the local decisions, as well as the decisions of the federal courts.

4. If there were a violation of the Securities Act of 1933 involved in the determination of this case, the decision would not be in conflict with the decision of the Circuit Court of Appeals of any other circuit, nor of this Court, but would be entirely in accord with the decision of this Court in *A. C. Frost & Co.* v. *Coeur d'Alene Mines Corp.*, 312 U. S. 38.

ARGUMENT

No Question of Federal Law

The Circuit Court of Appeals properly rejected petitioner's claim that respondent could not enforce the agreement in suit with his confidential adviser because it was tainted with illegality. The asserted illegality consisted of the failure of a registration statement filed by the Bath Corporation under the Securities Act of 1933 to disclose certain information of doubtful materiality.

The evidence disclosed a close relationship between the parties to the contract extending over a long period of time. It appeared that the confidential adviser, petitioner, had carried on all negotiations for marketing the stock and had proposed the form in which the deal should be cast to carry out a prior agreement for division of the profits from the stock. When suit was started, the particular shares of stock

claimed by respondent and other stocks were held by the Bank of Manhattan as collateral to a joint note of petitioner and respondent and prior to trial all of these securities were deposited with the Clerk of the District Court under what was in effect an order of interpleader (R. 97 to 102).

This is not a case where rights are claimed under the Securities Act of 1933. Petitioner is not a member of the class intended to be protected by that Act. This case in no way involves any of the administrative duties of the Commission under the Securities Act of 1933. The Act requires disclosure in a specified manner of *material* information concerning securities which are offered to the public. The present case presents no question concerning the interpretation or application of any of the requirements of the Act. The most that can be said is that it *might* have been necessary to determine whether the information omitted from the registration statement was material, but as will be pointed out hereafter, the Circuit Court of Appeals did not find it necessary to decide that question.

Petitioner has not denied the existence of his confidential relationship with respondent and the nature and extent of this relationship is clearly shown by the testimony (see *supra,* p. 3). The lower courts have concurred in finding that the disputed contract was made at the suggestion of petitioner because of his false representation that a different procedure would be illegal (R. 2469-70, 2514, 2542). It is undisputed that respondent was not told that the procedure suggested by petitioner was illegal in any way (R. 1925). It is conceded that respondent was not a party to nor signatory of the registration statement which is alleged to be deficient. Petitioner himself testified that respondent had no contact with the underwriters or experts preparing the registration statement until a day or two before the statement was filed (R. 683, 1026, 2484) and petitioner further testified that the underwriters, one Allen Melhado and petitioner were the only ones who had anything to do with the negotiations for the sale of the stock (R. 1025). It appears

from undisputed documentary evidence (Ex. 250, R. 2169, 481) that petitioner himself confirmed the information set forth in the registration statement which he now alleges was incorrect.

The lower courts have concurred in their findings and conclusions that the contract here involved is legal, valid and enforcible (R. 2512, 2514, 2519, 2542, 2592-3). It was further found by the lower courts that the underlying agreement concerning the Bath Corporation stock between these parties was made months before this particular underwriting arrangement was contemplated (R. 2467).

Petitioner does not contend that the particular agreement shown by the testimony was illegal. He claims that the agreement was improperly conceived and used so as to conceal his interest in 18,000 shares of stock which were sold to the underwriters. The agreement was conceived by petitioner (R. 2591-2; 2469-70) and respondent made no use of it. If it was used as a means of concealing any fact from the underwriters, or from the experts, or from the public, that use was conceived and carried out by petitioner. Petitioner had undertaken to make all of the arrangements for the marketing of the stock (R. 2467) and he performed that undertaking. He now claims that it was performed in such a manner by him as to prevent respondent from enforcing the very agreement under which petitioner acquired his only interest in the stock or the profits therefrom.

No Participation by Respondent

Petitioner has attempted to connect respondent with the alleged illegality by referring to a finding or conclusion of the District Court, rejected by the Circuit Court of Appeals, that the purpose of the agreement was to conceal petitioner's interest in the sale of the stock (R. 2542). The District Court stated that the methods and reasons for the agreement were discussed by the parties (R. 2544), but the only discussion shown by the evidence was petitioner's

false statement that he couldn't sell any of his own stock "because under the laws of the S E C you cannot do that" (R. 210, 2469). There was no mention at any time of disclosure or concealment. Certainly respondent's purpose was not to conceal the agreement because it is obvious that he had no knowledge concerning what disclosures, if any, were required in a registration statement (R. 367). Certainly, as pointed out by the Circuit Court of Appeals (R. 2593, 2594), respondent had nothing to gain from any such omission from the registration statement and no motive to conceal the information which was omitted therefrom. There was no agreement for concealment, no discussion of concealment, no motive for concealment and no knowledge that disclosure was required.

There is no support in the record for the inference by the District Court that the agreement was made for an improper purpose. That inference was based apparently upon the simple fact that the agreement was made. It was properly rejected by the Circuit Court of Appeals. Certainly where parties have a perfectly valid agreement to divide the profits from a transaction, it cannot be inferred that they have adopted an illegal method of effecting such division from the fact that they enter into another valid agreement concerning the procedure which would be followed. The inference of an improper purpose and motive which was made by the District Court and which is so strongly relied upon by petitioner, cannot be supported. *Pa. R. R. Co.* v. *Chamberlain* (1933) 288 U. S. 333, at 339; *Fidelity & Deposit Co.* v. *Grand National Bank of St. Louis* (C. C. A. 8th, 1934) 69 F. (2d) 177. In the latter case the court said at page 183:

> "There is a presumption not only of innocence, but of good faith. There is a presumption that business is conducted lawfully, Missouri Pacific R. Co. *v.* Prude, 265 U. S. 99, 44 S. Ct. 450, 68 L. Ed. 919, and that all things are rightly done, Chesapeake & O. R. Co. *v.* De Atley, 241 U. S. 310, 36 S. Ct. 564, 60 L. Ed.

> 1016; and where the act of a party may be referred indifferently to one of two motives, the law prefers to refer it to that which is honest, rather than to that which is dishonest, Alexander *v.* Fidelity Trust Co. (C. C. A. 3) 249 F. 1. As said by this court in American Surety Co. *v.* Citizens' Natl. Bank (C. C. A. 8) 294 F. 609, 616: 'Until there be reasonable ground to think otherwise, a presumption prevails that one acts honestly and keeps within the requirements of the law.' "

It is entirely clear upon this record that the purpose of the agreement that respondent should option 18,000 shares of stock for the petitioner was to carry out the prior agreement of March 1936, that the profits from the stock would be divided between them on the basis of 25% to petitioner and 75% to respondent. In determining the method to be followed, respondent, an industrialist, gave no consideration to any requirements of the Securities Act of 1933, but relied upon petitioner, an experienced lawyer, to see that the arrangements for marketing the stock were made in a proper manner.

Petitioner attempts to attribute a sinister purpose to the 18,000 share arrangement by referring to it as "secret". There was nothing secret about it. Both petitioner and respondent discussed its exact terms with at least six of the witnesses in this case, including two government agents (R. 452-3, 402-7, 430, 486-7, 1988, 552-4) and petitioner wrote a letter to one of the government agents in which he stated exactly what was being done (Ex. 325, R. 2251, 1314).

Fiduciary Relationship

We have here a case of a person owning stock who is about to sell a part of his holdings to underwriters for public distribution, and recognizing his own lack of knowledge, entrusts all of the details to one in whom he reposes trust and confidence and whom he believes to be competent

and experienced. The Circuit Court of Appeals properly recognized and gave effect to this situation. That court said:

> "It is to be remembered that Buckley was a lawyer of experience upon whom Judson would evidently rely (and he testified that he did rely) in such a complex matter as a registration statement. Buckley told Judson that it was necessary to cast the transaction in the form adopted in order to comply with the law. Judson accepted Buckley's plan, yet even as late as January, 1937, he wrote to his tax counsel indicating that he did not understand the necessity for it (Defendant's Exhibit 86).
>
> "In view of the circumstances of the present case, it seems to us that Judson was in the position of a person having nothing to gain by any errors in the registration statement, and that so far as he had any share in them, he had it because of the guidance of Buckley, who was his agent and confidential adviser" (R. 2594).

Under these circumstances, where the alleged illegality is not the commission of a heinous crime, it would create an anomalous situation to sustain the agent's plea that he had misrepresented his client or mishandled the matter entrusted to him and thus bar the principal's enforcement against the agent of a perfectly lawful agreement. It has been held in numerous cases that such a plea by a confidential agent or fiduciary cannot be sustained.

Ford v. *Harrington* (1857) 16 N. Y. 285;
Tracy v. *Talmadge* (1856) 14 N. Y. 162;
Norton v. *Blinn* (1883) 39 Ohio St. 145;
Place v. *Hayward* (1889) 117 N. Y. 487;
Brooks v. *Martin* (1863) 2 Wall. 70;
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Ingersoll v. *Weld* (1905) 103 App. Div. (N. Y.) 554;
Duval v. *Wellman* (1891) 124 N. Y. 156;
Wood v. *Rabe* (1884) 96 N. Y. 414.

See also—

Kinsman v. *Parkhurst* (1855) 59 U. S. 289, 293; 18 How. 289, 293;
Steele v. *Drummond* (1927) 275 U. S. 199;
Van Tines v. *Hilands* (S. D. N. Y. 1904) 131 Fed. 124;
Twin City Co. v. *Harding Glass Co.* (1931) 283 U. S. 353, 356.

Neither the petition for writ of certiorari nor the brief in support thereof points out anything that respondent should have done or could have done to correct the registration statement if any correction were needed. As previously stated, respondent was not called upon to give any information to those who prepared the registration statement except to make a disclosure concerning the amount of stock which he owned and that disclosure was correct and accurate (D's. Ex. 97; R. 2423-5, 1979). The only suggestion that some further act of Judson's would have corrected a deficiency is contained in the opinion of the Circuit Court of Appeals where it is said

> "It does appear that at this point [January, 1937, more than three months after the filing of the original registration statement] Judson realized that the registration statement did not properly state the number of shares he and Buckley were selling and he took no steps to have it amended" (R. 2593).

The record shows, however, that respondent discussed the question of amendment with petitioner and left the disposition thereof to petitioner. Petitioner testified that he discussed the matter with the attorney for the underwriters who objected to any amendment because the 50,000 shares of stock sold by the Bath Corporation had already been sold and paid for (R. 696-7).

The Alleged Illegality is Collateral and Remote

The stock which respondent was awarded was not sold to the underwriters nor distributed to the public. Respondent recovered shares which were registered in the name of petitioner before any agreement was made for optioning any stock for petitioner's account. Respondent is entitled to the shares which were awarded to him under his agreement with petitioner of March, 1936. In order to carry out that agreement, as stated by the Circuit Court of Appeals,

> "it was practically necessary to sell the shares of stock, from whatever block derived, for the account of each (petitioner and respondent) in proportion to his interest in the proceeds. Otherwise, it would have been open to either of these men who, as coadventurers, owed each other reciprocal obligations to deal in good faith, to take an unconscionable advantage of the other" (R. 2595-6).

The alleged illegality in connection with the marketing of the stock would not bar enforcement by respondent of his valid contract with petitioner.

Brooks v. *Martin* (1863) 2 Wall 70;
Planters' Bank v. *Union Bank* (1872) 16 Wall 483, 499;
Langley v. *Devlin* (1917) 95 Wash. 171;
Tracy v. *Talmadge* (1856) 14 N. Y. 162;
Hanover Natl. Bank v. *First Natl. Bank* (C. C. A. 8th, 1901) 109 Fed. 421;
State v. *Capital City Bank,* (1927) 32 N. M. 369.

The policy of the law which imposes reciprocal duties upon those in the relationship of the parties to this suit is illustrated by *Meinhard* v. *Salmon* (1928) 249 N. Y. 458.

Petitioner is Not Entitled to Affimative Relief

Petitioner here contends that respondent should not be permitted to enforce a contract because of an alleged illegality. But if respondent is denied enforcement and petitioner is awarded the stock in the custody of the court, the petitioner would in effect receive affirmative relief. He would receive shares of stock for which he has never paid and which have never been in his possession except for the moment required to endorse the certificates and pass them back to the possession of the Collector of Internal Revenue.

When petitioner suggested that the agreement for division of the profits be expressed by giving him an interest in the stock, he agreed that the stock should be held by respondent or in respondent's account until his share of the purchase price had been paid (R. 2512-3, 2570). This was subsequently expressed in the written note and memorandum (Ex. 280 A & B, R. 2196-7; 551) by which respondent was given a lien upon all the Bath Corporation stock in which petitioner had an interest as security for all of petitioner's indebtedness to respondent. Respondent's right to possession of these securities has at all times been superior to the right of petitioner. Their respective rights to possession were subject to various prior liens at the time this suit was instituted, but when those liens were discharged, petitioner's right was subject to the lien of respondent and that lien has never been discharged. The lower courts so held.

The lower courts were called upon to determine the right to possession and if a decree had been entered awarding this possesion to petitioner, he would have obtained enforcement of respondent's agreement to transfer 25% of the securities purchased to him. The law is well settled that a defendant claiming illegality cannot himself secure affirmative relief and it is well stated in *Buchhalter* v. *Rude* (C. C. A. 10th, 1931) 54 F. (2d) 834, modified as to costs 286 U. S. 451, cited in the opinion of the Circuit Court of Appeals, that where the court must determine as between

two wrongdoers which should have possession of securities in the hands of a third party, the award will be made without taking into consideration the wrongful act in which they both participated. See also *Langley* v. *Devlin* (1917) 95 Wash. 171.

The Decision of the Circuit Court of Appeals Is In Accord with Applicable Law

The decision in the Circuit Court of Appeals was not based upon any interpretation of the Securities Act of 1933 and was not dependent upon the materiality of any omissions from the registration statment filed under that Act. But even if it were conceded for the purpose of argument, contrary to all the facts shown by this record, that there was a violation of the Securities Act of 1933 in which respondent knowingly participated, the result which was reached by the Circuit Court of Appeals—enforcement of the contract between petitioner and respondent—would be in accord with the decision of this Court in the case of *A. C. Frost & Co.* v. *Coeur d'Alene Mines Corp.*, 312 U. S. 38.

The materiality to prospective investors of the information which was omitted from the registration statement was not determined by the Circuit Court of Appeals, though that court quite properly commented upon the relative unimportance of the omitted information. Certainly it is difficult to see how the errors complained of "could mislead prospective purchasers as to the value of the stock or really prejudice them in any way" (R. 2593). Further, "Disclosure that Judson was to share in the underwriting profits would, if anything, have given the impression that the shares were more valuable than one might have supposed from the $6 sale price * * *" (R. 2593). Obviously, a disclosure that petitioner was participating in the sale of stock to the underwriters would have added very little to the disclosures actually made that the holders of more than 87% of the outstanding shares, including all of the officers of the Company, were participating in the sale and that

petitioner and respondent were associated in various business enterprises (R. 2349, 2354-5, 2334).

There was no finding either by the Special Master or by the District Court that the omitted information was material in any way. Yet each denied enforcement of the contract because certain information was omitted from the registration statement, although non-disclosure of facts is of no consequence under the Securities Act of 1933 unless the omissions are "material". It does not appear that either the Special Master or the District Court considered that limitation, but it is entirely clear that the Circuit Court of Appeals granted enforcement of the contract regardless of any question of materiality.

Petitioner attempts to distinguish the *Frost* case on the ground that the violation of the Securities Act involved therein was comparatively slight. The violation in that case consisted of the knowing failure to file any registration statement at all. In the instant case the claimed defect in the registration statement, which correctly set forth the stock holdings of both respondent and petitioner and the number of shares optioned by respondent, would have been entirely eliminated if there had been included a reference to the agreement between them with respect to the 18,000 shares of stock.

Furthermore, in the *Frost* case this Court allowed an underwriter to recover damages from an issuer. Both parties were directly concerned in the public offering of the stock. Although they had knowingly failed to file any registration statement, the underwriter recovered damages from the issuer for breach of contract.

In the *Frost* case this Court decided that it was not the intention of Congress to impose in the Securities Act of 1933, in addition to the express penalties there set forth, the added sanction that contracts involving a violation of the statute should be void. The Securities Act became law in 1933 and has been amended since that time in various particulars, but no amendment has added any such pro-

vision. Petitioner urges that this Court erred in the *Frost* case, but it is submitted that its decision was clearly correct in not imposing a sanction which Congress itself had failed to include in the Act.

In the *Frost* case, this Court quoted with approval from *Twin City Co.* v. *Harding Glass Co.*, 283 U. S. 353, at 356-7, that the rule that contracts in contravention of public policy are not enforcible

> " 'should be applied with caution and only in cases plainly within the reasons on which that doctrine rests. It is only because of the dominant public interest that one who, like respondent, has had the benefit of performance by the other party will be permitted to avoid his own promise.' "

The contract herein which was enforced in favor of respondent did not violate the Securities Act of 1933 nor any rule or regulation thereunder, as found in the lower courts (R. 2519, 2514, 2592-3), and the performance of that contract did not require any such violation. Respondent is not responsible in any manner for any violation of the Act which may have occurred and it is extremely doubtful that the information omitted from the registration statement did violate the Act. But even if there were a violation, the contract would be enforcible on the authority of *A. C. Frost & Co.* v. *Coeur d' Alene Mines Corp., supra.*

Conclusion

There is no important public question involved in this case. There is no conflict between the decision of the Circuit Court of Appeals and the decision of a similar question by the court in any other circuit, nor by this Court. The question actually decided by the Circuit Court of Appeals in the present case was the effect of a particular relationship between the parties upon the respondent's right to enforce a contract not referred to in a registration state-

ment, where the subject matter of the suit was under the control of the court, so that affirmative relief had to be given to one of the parties and where the alleged illegality was past and remote. The petition for writ of certiorari should be denied.

Respectfully submitted,

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